AVCORP

annual report 2001

report to shareholders

In our last annual report we said that in 2001 we expect to:

increase our customer base	**we signed a $100 m contract with a new customer—Cessna**
increase our revenue	**we increased revenue by 19.7%**
be profitable	**we made a profit of $2.2 million**

All of our operational and financial targets were met in 2001.

The economic slowdown that started in September has affected our outlook for 2002. The aerospace industry in general is projecting declining revenue in 2002—in Avcorp's case, we expect revenue to decrease 25%. We continue to believe that there are many good reasons for our shareholders, customers, lenders and employees to be optimistic about Avcorp.

In 2002, we expect to win more major new contracts, we expect to continue to lower costs and inventory, and we expect to continue to meet our commitments to customers. We have the people, the equipment and the commitment necessary to meet our targets and ensure that shareholder value is delivered.

David Levi Chairman	**John H. Nicholson** President and Chief Executive Officer

management discussion & analysis

Financial Highlights

increasing revenues

years ended September 30 *expressed in thousands of Canadian dollars except per share amounts*	**2001**	2000	1999	1998	1997
Operations					
Revenues	**96,921**	81,261	89,559	66,903	45,217
Revenues excluding sale of IP* to Bombardier	**96,921**	81,261	81,076	66,903	45,217
EBITDA** from continuing operations	**9,102**	(3,321)	(5,220)	5,685	2,631
EBITDA less loss on sale of IP to Bombardier	**9,102**	(3,321)	1,989	5,685	2,631
Operating earnings (loss) before tax and capital gain on disposal of land	**2,258**	(10,212)	(10,606)	2,942	1,594
Net earnings (loss)	**2,155**	(9,907)	(10,756)	2,810	2,127
Financial Position					
Net capital expenditures	**653**	1,207	5,654	24,660	10,662
Total assets	**67,881**	74,670	90,331	86,856	43,153
Bank indebtedness and long-term debt	**34,435**	46,191	46,378	37,958	1,749
Shareholders' equity	**17,908**	13,639	23,417	35,053	33,426
Ratio debt/equity	**1.92**	3.39	1.98	1.08	0.05
Shares outstanding at year end	**14,612**	13,301	13192	13,450	13,873
Book value per share	**1.23**	1.03	1.78	2.61	2.41

* *IP = intellectual property for CRJ700 program*
** *EBITDA = earnings before interest, taxes, depreciation and amortization*

Overview

2001 was a year of turnaround...

The Company is a leading provider of engineering design and manufacture of parts, sub-assemblies and complex major assemblies for aircraft manufacturers. Products—which include simple aluminum brackets, high-strength interior panels, fuel tanks, structural wing components as well as fully-integrated vertical and horizontal stabilizers—are used in Airbus, Boeing, Bombardier, Cessna and Bell Helicopter aircraft.

The Company employs approximately 700 people at three modern facilities in Delta, British Columbia and Laval and Granby, Quebec. State-of-the-art manufacturing facilities and systems and a highly-trained workforce ensure the high quality and on-time delivery of its products.

2001 was a year of recovery for Avcorp. Through a renewed focus on meeting commitments to customers, a series of cost reduction actions, attention to working capital management, and revitalization of sales and marketing, the Company achieved:

- Revenues of $96.9 million—a 19.3% increase over 2000
- Profit of $2.2 million—a $12.1 million improvement over 2000
- Reduction of total debt over the year of $12.1 million
- New contracts and renewals of $220 million with Boeing and Cessna
- Sales backlog increase to $320 million—$39 million higher than at the end of 2000 ($281 million)
- On-time deliveries greater than 98% compared to 85% in 2000
- Quality measures of 99.9%

The Company is continuing to raise productivity and increase inventory utilization through the implementation of Lean Manufacturing techniques and to effectively market its products and services.

Overview *continued*

...and a year of revitalization

Management has reviewed and assessed the impact of the tragic events of September 11, 2001 and the general economic slowdown on the Company. Initial restructuring was implemented in September and related costs were recognized in the reported financial results for the year ending September 30, 2001. The Company's inventory valuation processes were rigorously applied to ensure that the inventory provisions appropriately reflect the expected reduction in usage in light of forecast revenue reductions. Additional actions may be required in response to any further downturns in market conditions and any related costs will be expensed as incurred.

Operating Results

revenues increased to $96.9 million

Supplemental Statement of Operations

This supplementary statement of operations is provided for comparison purposes to segregate recurring revenues and costs from unusual items:

years ended September 30 *expressed in thousands of Canadian dollars except per share amounts*	**2001**	2000
Revenues	**96,921**	81,261
Gross profit	**17,629**	11,566
as a percentage of sales	***18.2%***	*14.2%*
Administrative and general expenses (excluding other items detailed below)	**8,270**	8,613
as a percentage of sales	***8.5%***	*10.6%*
Earnings before interest, taxes, depreciation, amortization and other items	**9,359**	2,953
Depreciation and amortization	**3,124**	3,366
Interest	**3,720**	3,525
Write-down of inventory	**-**	4,509
Severance costs	**-**	800
Change in estimate - CRJ700 risk-sharing contract	**257**	500
Other non-recurring contract costs	**-**	465
	7,101	13,165
Earnings (loss) before taxes and capital gain on disposal of land (2000: $440)	**2,258**	(10,212)

Revenue

Fiscal 2001 revenues were $96.9 million, representing a 19.3% increase of $15.7 million over revenues of $81.3 million last year. Increases were broadbased across all customers and major product lines.

The Company's two principal customers, Bombardier Aerospace and Boeing Commercial Airplane Group, accounted for 92% of 2001 sales, unchanged from 2000.

Gross Profit

Gross profit increased to 18.2% from 14.2%, resulting from fixed costs remaining constant, operational improvements, headcount reductions and procurement initiatives.

Sales, General and Administrative

Sales, general and administrative expenses reduced from 10.6% of revenue to 8.5% due to headcount reductions, elimination of certain expenses and improved controls over others.

Earnings Before Interest, Taxes, Depreciation & Amortization

Earnings (loss) before interest, income taxes, depreciation and amortization (EBITDA) was $9.1 million as compared to a loss of $2.9 million last year (including the capital gain on the disposal of land).

Interest

Total interest on both short- and long-term debt for the year was $3.7 million as compared to $3.9 million last year. All interest was expensed during the year. During 2000, $323,000 was capitalized to assets under development resulting in a net expense of $3.5 million.

CRJ700 Risk-Sharing Contract

The change in the estimate recorded in 2001 is the result of management's review of the expected lifetime units of production for this program.

Significant Items

2001

None

2000

Capital Gain On Disposal Of Land
The Company received $1.1 million from the sale of land adjacent to its production facilities in Delta, BC. A capital gain of $440,000 was recorded on the sale. The proceeds were used to reduce the long-term debt of the Company.

Severance Costs
The 2000 severance costs of $800,000 were charged to operations in the third quarter.

Write-Down Of Inventory
A full count and valuation of inventory was conducted at the Delta, BC location during 2000. The determination of inventory valuation included a review of obsolescence, appropriateness of quantities on hand in relation to anticipated future orders, and carrying cost in comparison to expected selling price, or net realizable value.

Income Taxes

Effective October 1, 2000, the Company changed its method of accounting for income taxes, more fully described in notes 1 and 13. The Company's tax provision comprises large corporation tax of $103,000 (2000: $135,000). The Company has available non-capital tax loss carry-forwards totalling approximately $5.2 million. In addition, $19.6 million in unclaimed capital cost allowance and $4.1 million in unutilized research and development costs are available to reduce future taxable earnings.

Operating Results *continued*

$2.2 million net profit

Net Earnings

The items detailed above resulted in a net earnings of $2.2 million ($0.16 per share) as compared to the net loss of $9.9 million ($0.75 per share) in 2000.

Liquidity and Capital Resources

The Company ended the year with a bank balance position of $595,000, compared to $8.1 million bank line utilization at the end of 2000.

Cash provided from operating activities, before consideration of changes in non-cash items relating to operating activities, was $5.8 million compared to utilization of $2.8 million in the previous year. 2000 results included a write-down of inventory of $4.5 million, which did not affect cash.

Non-cash operating assets and liabilities provided $3.9 million of cash compared to the utilization of $2.2 million in the previous year. The improvement in cash reflected better management of all working capital accounts.

During 2001, the Company purchased capital assets totaling $653,000.

Financing activities utilized $8.5 million of cash. This resulted from the elimination of the $8.1 million bank indebtedness, the retirement of $4.0 million of long-term debt, the addition of $2.1 million of equity (net of expenses) through a private placement, and the contribution of $1.5 million from a settlement with an equipment supplier.

Outlook

opportunities

The Company's products are provided to manufacturers of large commercial passenger and cargo aircraft, regional and corporate jets, as well as helicopters. The Company plans to remain focussed on the aerospace industry and to seek opportunities to increase the range of products it provides to the industry.

There are many new opportunities for the Company that could increase revenues. These opportunities arise from new civil aircraft types under consideration as well as from continuing major outsourcing initiatives by aircraft manufacturers and from opportunities with military programs. Along with focussing on revenue growth, the Company is continuing to invest in its manufacturing processes and equipment to lower both operating costs and inventory requirements.

Since September 2001, aircraft operators have delayed deliveries of new aircraft, which in turn has resulted in reduced demand for the Company's products. The Company is expecting revenue from current contracts to reduce by 25% in fiscal year 2002 and possibly beyond. The Company anticipates that revenues from current contracts could begin to return to previous levels in fiscal year 2003 and return to prior levels in 2004. The new contracts with Cessna are projected to add significantly to revenue in 2004.

report of management

The accompanying financial statements of Avcorp Industries Inc. and all other information contained in the Annual Report are the responsibility of management. The financial statements were prepared in conformity with Canadian generally accepted accounting principles appropriate in the circumstances, in a manner consistent with the previous year, and include some amounts based on management's best judgments and estimates. The financial information contained elsewhere in this Annual Report is consistent with that in the financial statements.

Management is responsible for maintaining a system of internal accounting controls and procedures to provide reasonable assurance, within an appropriate cost/benefit relationship, that assets are safeguarded and that transactions are authorized, recorded and reported properly. Management believes that the Company's internal accounting controls provide reasonable assurance that assets are safeguarded against material loss from unauthorized use or disposition, and that the financial records are reliable for preparing financial statements and other data and maintaining accountability for assets.

The Audit Committee of the Board of Directors, composed of directors, none of whom are officers of the Company, meets with the independent auditors and management to discuss internal accounting controls, auditing, and financial reporting matters. The Committee reviews, with the independent auditors, the scope and results of the audit examination. The Committee also meets with the independent auditors, without management present, to ensure the independent auditors have free access to the directors. The Committee reviews the annual financial statements and recommends their approval by the Board of Directors.

The independent auditors, PricewaterhouseCoopers, are appointed by the shareholders to examine the financial statements of Avcorp Industries Inc. and to conduct such tests and related procedures as they deem necessary in conformity with Canadian generally accepted auditing standards. The opinion of the independent auditors, based upon their examination of the financial statements, is contained in this Annual Report.

John Nicholson

JOHN H. NICHOLSON
President and
Chief Executive Officer

report of auditors

To the shareholders of Avcorp Industries Inc.

We have audited the balance sheets of Avcorp Industries Inc. as at September 30, 2001 and 2000 and the statements of operations, deficit and cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at September 30, 2001 and 2000 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

PRICEWATERHOUSECOOPERS LLP
Chartered Accountants

Vancouver, British Columbia
November 30, 2001 (except note 17, which is as at December 19, 2001)

balance sheets

expressed in thousands of Canadian dollars except per share amounts

For the years ended Sept 30

	2001	2000
ASSETS		
Current Assets		
Bank	**595**	-
Accounts receivable	**10,916**	11,657
Inventories (notes 1 and 3)	**19,700**	23,714
Prepayments and other assets (note 4)	**805**	756
	32,016	36,127
Capital Assets (note 5)	**35,715**	38,393
Other Assets (note 4)	**150**	150
	67,881	74,670
LIABILITIES		
Current Liabilities		
Bank indebtedness (note 6)	**-**	8,108
Accounts payable and accrued liabilities	**11,801**	9,847
Deferred revenue	**3,737**	4,993
Current portion of long-term debt (note 7)	**3,611**	3,294
	19,149	26,242
Long-Term Debt (note 7)	**30,824**	34,789
	49,973	61,031
Shareholders' Equity		
Capital stock (note 9)	**30,219**	28,105
Deficit	**(12,311)**	(14,466)
	17,908	13,639
	67,881	74,670

Contingencies and commitments (note 12)
Subsequent event (note 17)

Approved by the Directors

David Levi, Chairman

J. Ian Flatt, Director

statements of operations

expressed in thousands of Canadian dollars except per share amounts

For the years ended Sept 30

	2001	2000
Revenues (note 1)	**96,921**	81,261
Cost of sales and expenses (note 2)		
Cost of sales	**79,549**	75,269
Administrative and general expenses	**8,270**	9,313
Depreciation and amortization	**3,124**	3,366
Interest (note 10)	**3,720**	3,525
	94,663	91,473
Earnings (loss) before income taxes	**2,258**	(10,212)
Income taxes (note 13)	**(103)**	(135)
Earnings (loss) after income taxes	**2,155**	(10,347)
Gain on disposal of land	**-**	440
Earnings (loss) for the year	**2,155**	(9,907)
Basic earnings (loss) per share	**0.16**	(0.75)
Diluted earnings (loss) per share	**0.16**	(0.75)
Weighted average number of basic and diluted shares outstanding (000's)	**13,519**	13,258

statements of deficit

expressed in thousands of Canadian dollars except per share amounts

For the years ended Sept 30

	2001	2000
Deficit - Beginning of Year	**(14,466)**	(4,559)
Earnings (loss) for the year	**2,155**	(9,907)
Deficit - End of Year	**(12,311)**	(14,466)

statements of cash flows

expressed in thousands of Canadian dollars except per share amounts

For the years ended Sept 30

	2001	2000
Cash flows from operating activities		
Earnings (loss) for the year	**2,155**	(9,907)
Items not affecting cash (note 11(a))	**3,661**	7,127
	5,816	(2,780)
Change in non-cash items related to operating activities (note 11(b))	**3,918**	(2,249)
	9,734	(5,029)
Cash flows from investing activities		
Shareholder and employee loans - net	**-**	47
Purchase of capital assets	**(653)**	(933)
	(653)	(886)
Cash flows from financing activities		
Reduction in bank indebtedness	**(8,108)**	(1,060)
Proceeds from CRJ700 program deferred revenue	**-**	5,669
Proceeds from settlement with equipment manufacturer	**1,486**	-
Proceeds from disposal of land	**-**	1,072
Proceeds from long-term debt	**-**	4,000
Repayment of long-term debt	**(3,978)**	(3,895)
Issue of common shares	**2,294**	129
Share issue expense	**(180)**	-
	(8,486)	5,915
Net change in cash and cash equivalents	**595**	-
Cash and cash equivalents Beginning of year	**-**	-
Cash and cash equivalents End of year	**595**	-

1. Significant accounting policies

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and the reported revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue recognition

Revenue is accounted for under three methods.

a) Revenue from contracts with short production cycles is recorded as deliveries are made.

b) Revenue from contracts with long production cycles is recognized using the percentage-of-completion method. The percentage complete is calculated based upon contract costs incurred to date compared with total estimated contract costs. The percentage complete is then applied to total anticipated contract revenue to determine the period's revenue. A provision for the estimated loss is made when contract costs are expected to exceed estimated contract revenue.

c) Revenues from development contracts requiring estimates of revenues, cost of sales and delivery periods associated with forecasted orders is recognized using program accounting. The ability to reasonably estimate these amounts is an integral part of program accounting. Estimates are reviewed on a regular basis and changes in estimates are recognized over future periods, with the exception of anticipated losses which are recognized in the period when losses are reasonably assured. Revenue is recognized in relation to units delivered, with the cost of sales being determined by applying the ratio of total estimated production costs for a predetermined number of program shipsets over the estimated total revenue for those shipsets. For new programs, the predetermined number of program shipsets is initially based on an established number of units representing what management believes is a conservative projection of units to be sold.

Inventories

Raw materials are valued at the lower of cost or net realizable value. The cost of raw materials is determined on a weighted average basis. Programs and contracts in progress and finished goods are valued at the lower of standard cost (which is calculated to approximate actual costs) or net realizable value. The cost of programs and contracts in progress is determined in accordance with the percentage of completion or program accounting methods.

Inventory costs on long-term programs include raw materials, labour and applicable overheads and comprise production costs and learning curve costs. Learning curve costs comprise production costs incurred in the early stages of a program, in excess of the average estimated unit cost for the entire program. Learning curve costs are capitalized and included in inventory to the extent that their recovery is regarded as reasonably assured from future program revenues. The learning curve concept anticipates a predictable decrease in unit cost as tasks and production techniques become more efficient through repetition and management action. The interest and financing costs relating to specific programs are included in program costs. In accordance with industry practice, current assets include inventoried costs relating to programs and contracts with long production cycles that are not expected to be realized within one year.

Translation of foreign currencies and financial instruments

Assets and liabilities in U.S. dollars are converted into Canadian dollars at the rate of exchange prevailing at the year-end. Revenue and expenses in U.S. dollars are converted into Canadian dollars at rates of exchange prevailing on transaction dates. Translation gains or losses are included in the Statement of Operations, except those related to the translation of long-term debt, which are deferred and amortized over the term of the related debt.

To manage exposures resulting from foreign exchange fluctuations, the Company may enter into foreign exchange contracts on specifically identified transactions as a hedge of known and estimated foreign denominated cash flows.

Income taxes

Effective October 1, 2000, the Company changed its method of accounting for income taxes from the deferral method to the liability method as required by the new Canadian Institute of Chartered Accountants standard #3465. The liability method requires that accumulated tax balances be adjusted to reflect changes in the tax rates. This standard was applied retroactively, however the change in method of accounting for income taxes did not result in a difference in deficit as at September 30, 2000.

Future income taxes reflect the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

Capital assets

Capital assets are recorded at cost, plus capitalized interest on large construction projects, less related government grants and investment tax credits. Depreciation is calculated using the straight-line method over the following estimated useful lives of the assets or on a units-of-production basis:

1. Significant accounting policies *continued*

Buildings	40 years
Machinery and equipment	2 - 15 years
Robotics	units-of-production basis
Leasehold improvements	over the term of the lease plus one renewal period

Convertible loans and debentures

Upon issuance, the convertible debentures and loans are classified into equity and financial components at their present value. The discount on the convertible debentures is accreted by way of a charge to earnings over the term of the debt.

Earnings (loss) per common share

Earnings (loss) per common share has been calculated using the weighted average number of common shares outstanding during the year. Effective fiscal 2001, the Company adopted the treasury stock method for calculating diluted earnings per share.

Deferred revenue

Deferred revenue represents non-refundable deposits received on long-term contracts, in excess of the revenue recognized under program accounting and is included in current liabilities.

Share purchase options

The Company from time to time issues shares purchase options as described in note 9(d). No compensation expense is recognized for this plan when shares or share options are issued. Consideration for shares issued on exercise of share purchase options is credited to capital stock.

2. Cost of sales and expenses

During 2000, the Company recorded several one-time charges within cost of sales and administrative and general expenses. These included a write-down of inventory ($4,509,000) following a comprehensive review of a full inventory count and adjustments to net realizable value, recognition of a change in estimate associated with the CRJ700 risk-sharing contract ($500,000), restructuring costs associated with reductions in manpower ($800,000), and certain other contract costs ($465,000).

3. Inventories

	2001 $	2000 $
Raw materials	5,649	6,060
Programs and contracts in progress	12,274	15,090
Finished products	1,777	2,564
	19,700	23,714

For programs under commercial production, learning curve costs amounted to $610,000 (2000 - $2,627,000), which have yet to be recovered from future customer orders and are included in programs and contracts in progress. During fiscal 2001, the Company settled a contractual performance issue with a supplier of manufacturing equipment used in these programs. The proceeds of $1,486,000 were applied to the learning curve costs.

Anticipated proceeds from future sales exceed the related costs in inventory as at September 30, 2001, plus the estimated additional production costs still to be incurred. However, unrecoverable costs may eventually be charged to expense in subsequent years, if fewer than the program quantity of units are sold, or the costs to be incurred on the program exceed current estimates.

4. Prepayments and other assets

	2001 $	2000 $
Prepaid expenses	805	648
Deferred financing charges outstanding	-	56
Shareholder loans	-	52
Total current prepayments and other assets	805	756
Employee loan	150	150

During 2000, the Company advanced $150,000 to an officer and director, which is repayable on March 15, 2005. This loan is secured by a second charge on a property and is interest free.

5. Capital assets

	2001			2000		
	Cost	Accumulated depreciation	Net	Cost	Accumulated depreciation	Net
	$	$	$	$	$	$
Land	2,314	-	2,314	2,314	-	2,314
Buildings	12,625	1,015	11,610	12,600	701	11,899
Machinery and equipment	39,020	17,422	21,598	38,637	14,669	23,968
Leasehold improvements	1,136	943	193	1,104	892	212
	55,095	19,380	35,715	54,655	16,262	38,393

Interest capitalized to assets under development during the year amounted to $nil (2000 - $323,000). Included in machinery and equipment and assets under development are assets held under capital leases at a cost of $16,809,000 (2000 - $17,017,000) and accumulated depreciation of $4,271,000 (2000 - $3,296,000).

6. Bank indebtedness

The Company has a $10,000,000 line of credit with interest at prime plus 2% per annum with a Canadian chartered bank, of which $nil had been drawn as at September 30, 2001 (2000 - $8,108,000). Substantially all of the Company's assets are pledged as security under the bank's general security agreement. Subsequent to year-end, the Company re-negotiated its line of credit; see note 17.

7. Long-term debt

	2001	2000
	$	$
Land and building mortgages (a)	16,813	17,128
Convertible debentures (b)	8,114	7,881
Equipment loans (c)	1,081	1,522
Capital leases (note 8)	7,196	10,251
Government loans (d)	664	1,039
Accrued government royalties	567	262
	34,435	38,083
Less: Current portion	(3,611)	(3,294)
	30,824	34,789

a) Land and building mortgages comprise:

i) $8,384,000 (2000 - $8,700,000) first mortgage with the bank, which bears interest at 7.91% and is repayable in equal monthly installments, with maturity in February 2003, ($4,345,000) and September 2003, ($3,417,000).

ii) $4,428,000 (2000 - $4,428,000) second mortgage with the Province of British Columbia, which bears interest at 7.75% and is repayable in forty quarterly installments which will commence on January 1, 2002.

iii) $4,000,000 (2000 - $4,000,000) second mortgage with the Province of British Columbia, which bears interest at 7.5%, with maturity in November 2003. The loan is convertible into 1,600,000 common shares up to maturity at a share price of $2.50 at the option of the Province of British Columbia. The Company can require conversion of the full amount of the loan in the event that the weighted average trading price of the Company's shares on the Toronto Stock Exchange is greater than 150% of the conversion price for twenty consecutive days; see note 9(a). These mortgages are secured by land and building at the Delta, British Columbia facility.

b) During 1998, the Company issued $8,000,000 of 8% convertible debentures, with $5,000,000 due August 2003, interest payable semi-annually, and convertible at the option of the holder into 1,075,269 shares at a conversion price of $4.65, and $2,500,000 due March 2003, interest payable at maturity or date of conversion, and convertible at the option of the holder into 625,000 common shares of the Company at a conversion price of $4.00 per share. The Company can require conversion of the full amount of either debenture in the event that the weighted average trading price of the Company's shares on the Toronto Stock Exchange is greater than 125% of the conversion price for fifteen or twenty consecutive days depending on the specific convertible debenture. During 1998, $500,000 of these debentures was converted into 125,000 common shares at a share price of $4.00; see note 9(b).

7. Long-term debt *continued*

These debentures are comprised of:

	2001		2000	
	Equity $	Debt $	Equity $	Debt $
Debentures due				
March 2003	61	2,477	61	2,462
August 2003	100	4,964	100	4,946
Accrued interest	-	673	-	473
	161	8,114	161	7,881

c) There are various equipment loans that have a weighted average interest rate of 7.69%. The loans are secured under the bank's general security agreement or by way of a charge against specific assets for those assets financed by parties other than the bank. The loans are repayable in equal installments over a period of five years.

d) A manufacturing modernization program was partially financed under two non-interest-bearing loans from government. The first loan of $1,452,000 is from the federal government and is repayable in seven consecutive annual installments, which began on December 31, 1997. The second loan of $223,000 is from the Province of Quebec and the balance of $56,600 is repayable in fiscal 2002.

e) Principal repayments, including amounts due under capital leases, required in each of the next five years and thereafter are:

	$
2002	3,611
2003	20,120
2004	7,323
2005	425
2006	425
Thereafter	2,531
	34,435

8. Obligations and commitments under leases

The Company has committed to payments under certain operating leases for leasehold buildings in Quebec and certain capital leases for computer equipment and manufacturing machinery and equipment.

Future minimum lease payments required in each of the next five years and thereafter under leases are:

	2001		2000
	Operating $	Capital $	Capital $
2001	-	-	2,830
2002	469	2,738	2,789
2003	469	2,874	2,925
2004	469	2,367	2,193
2005	469	-	1,412
2006	469	-	-
Thereafter	261	-	-
Total future minimum lease payments	2,606	7,979	12,149
Less: Imputed interest		783	1,898
Balance of obligation under capital leases included in long-term debt (note 7)		7,196	10,251

The capital leases provide for purchase options amounting to $2,168,000 (2000 - $2,440,000) exercisable at the termination of the lease period.

9. Capital stock

Authorized

Unlimited as to number

First preferred and second preferred shares, issuable in series, the terms of which will be determined by the directors at the time of creation of each series.

Common shares issued or reserved:

	Number of shares	Amount $
September 30, 1999	13,192,150	27,976
Incentive stock option plan shares exercised	108,502	129
September 30, 2000	13,300,652	28,105
Share issue (c)	1,311,000	2,114
September 20, 2001	14,611,652	30,219

a) The Company has reserved a total of 1,600,000 common shares, the maximum number that may be acquired pursuant to the Province of British Columbia financing; see note 7(a).

b) The Company has reserved a total of 1,700,269 common shares, the maximum number that may be acquired pursuant to the convertible debentures; see note 7(b).

c) During the year ended September 30, 2001, the Company issued 1,311,000 units in a private placement. Each unit was issued at $1.75 and consisted of one common share and 0.65 non-transferrable share purchase warrants. Each warrant entitles the holder to purchase one additional common share at a price of $1.75 for an 18 month period expiring February 2003. The costs of the private placement amounting to $180,000 were deducted from the proceeds in recording $2,114,000 as capital stock.

d) The incentive stock option plan of the Company is administered by the Board of Directors. The maximum number of common shares that may be optioned is 2,000,000. The period during which an option is exercisable shall not exceed ten years. A summary of the Company's stock option plan as of September 30, 2001 and 2000, and changes during the years ending on those dates, is presented below.

	2001		2000	
	Shares ('000)	Weighted average exercise price $	Shares ('000)	Weighted average exercise price $
Outstanding - Beginning of year	1,218	2.10	1,200	2.92
Granted	243	1.51	674	1.78
Exercised	-	-	(109)	1.18
Forfeited	(570)	2.52	(547)	3.68
Outstanding - End of year	891	1.68	1,218	2.10

The following table summarizes fixed stock options outstanding and exercisable.

	Option price $	Number (000's)	Weighted average remaining contractual life (years)	Weighted average exercise price $
Options outstanding and exercisable at September 30, 2001	1.00 - 1.50	180	2.97	1.18
	1.50 - 2.00	658	3.92	1.70
	2.00 - 2.50	18	4.18	2.10
	3.00 - 3.50	-	-	-
	3.50 - 4.00	35	1.08	3.60
		891	3.24	1.68

9. Capital stock *continued*

	Option price $	Number (000's)	Weighted average remaining contractual life (years)	Weighted average exercise price $
Options outstanding and exercisable at September 30, 2000	1.00 - 1.50	180	3.97	1.18
	1.50 - 2.00	732	4.60	1.80
	2.00 - 2.50	18	5.18	2.10
	3.00 - 3.50	188	0.53	3.28
	3.50 - 4.00	100	1.43	3.76
		1,218	3.62	2.10

10. Interest expense (income)

	2001 $	2000 $
Interest on capital leases	717	882
Interest on other long-term debt	2,018	2,089
Interest on short-term debt	985	877
	3,720	3,848
Interest capitalized	-	(323)
Net interest expense	3,720	3,525

11. Supplementary cash flow information

a) Items not affecting cash:

	2001 $	2000 $
Depreciation and amortization	3,124	3,366
Allowance for doubtful accounts	78	224
Write-down of inventory	-	4,509
Other items	459	(972)
	3,661	7,127

b) Changes in non-cash items:

	2001 $	2000 $
Accounts receivable	663	2,500
Inventories	1,595	(45)
Prepayments and other assets	(49)	(98)
Accounts payable and accrued liabilities	1,709	(5,204)
Deferred revenue	-	598
	3,918	(2,249)

11. Supplementary cash flow information *continued*

c) During the years ended September 30, 2001 and 2000, the Company conducted non-cash operating, investing and financing activities as follows:

	2001 $	2000 $
Non-cash operating activities		
Convertible debentures		
Interest accrual and equity accretion	(232)	(232)
Royalties accrued on CRJ700 program	(305)	(262)
	(537)	(494)
Non-cash investing activities		
Assets acquired under capital leases	-	(274)
Non-cash financing activities		
Convertible debentures		
Interest accrual and equity accretion	232	232
Royalties accrued on CRJ700 program	305	262
Capital leases	-	274
	537	768

d) Interest paid during the year was $3,183,000 (2000 - $3,646,000).

12. Contingencies and commitments

During 1998, an action was commenced against the Company for an amount of $1 million in respect of alleged future remediation costs relating to a property previously owned by the Company. A statement of defence has been filed. Management believes it is too early to assess the likelihood of the outcome of this litigation, and accordingly, no amounts have been accrued for in these financial statements.

13. Income taxes

a) A reconciliation of income taxes at statutory rates to actual income taxes is:

	2001 $	2000 $
Combined basis income tax rate	*41.6%*	*42.6%*
Income tax expense (recovery) at the basic income tax rate	939	(4,163)
Manufacturing and processing rate reduction	(141)	684
Large corporation tax	103	135
Other	13	17
Non-taxable portion of capital gain	-	(23)
Valuation allowance	(811)	3,485
	103	135

The tax effect of the change in statutory income tax rates during the year is immaterial to disclose separately.

13. Income Taxes *continued*

b) The tax effect of temporary differences that give rise to significant portions of future tax assets and future tax liabilities as at September 30, 2001.

	$
Future income tax assets	
Non-capital losses	1,697
Scientific research expenditures	1,328
Capital losses	897
Capital assets	2,200
Expenses not deductible in current period	225
	6,347
Future income tax liability	
Financing costs	(66)
Net future income tax asset	6,281
Less: Valuation allowance	(6,281)
	-

c) The Company has available non-capital loss carry forwards totalling approximately $5,200,000. These losses expire in 2007.

d) The Company has approximately $19,600,000 of current and prior years' unclaimed capital cost allowances that may be claimed against future taxable income.

e) The Company has approximately $4,105,000 of unclaimed research and development costs that may be claimed against future taxable income.

f) The company has accumulated net capital losses for tax purposes of approximately $2,773,000 which may be carried forward and used to reduce taxable capital gains in future years.

No future tax benefit has been recognized in these financial statements with respect to these losses.

14. Financial instruments

Financial risks

The financial risk to the Company's earnings arises from the fluctuations in foreign exchange rates and in interest rates and the degree of volatility of these rates. The Company has not generally used derivative instruments to reduce its exposure to interest or currency rate risk, with the exception of foreign exchange contracts taken out on specifically identified transactions. This is because purchases in U.S. dollars significantly offset sales in U.S. dollars in the normal course of business and consequently reduce the Company's exposure to currency rate risk. As U.S. dollar sales grow significantly larger than U.S. dollar purchases, the Company's intention is to manage the resulting exposure to currency rate risk through foreign exchange derivative instruments. No foreign exchange derivative instruments were outstanding at September 30, 2001 or 2000.

Credit risk

Concentrations of credit risk in trade accounts receivable are with major aircraft manufacturers in the North American aerospace industry. The Company considers the risk of non-performance to be remote due to the credit worthiness of these manufacturers and the Company's past experience with them.

Fair values

The fair values of the Company's accounts receivable, bank indebtedness, accounts payable and accrued liabilities are estimated to approximate their carrying values due to the immediate or short-term maturity of these financial instruments. The fair value of the long-term debt is estimated using present value techniques and assumptions concerning the amount and timing of expected future cash flows and discount rates which reflect current market rates on similar financial instruments.

	2001		2000	
	Carrying value $	Fair value $	Carrying value $	Fair value $
Long-term debt	34,435	34,264	38,083	37,011

15. Economic dependence and segmented information

a) Sales to two major customers accounted for approximately 92% (2000 - 92%) of sales.

b) The Company operates in one industry that involves the manufacture and sale of aerospace products. As a result the Company has only one operating segment. All of the Company's operations are in Canada.

c) Export sales were approximately $43,734,000 (2000 - $33,786,000).

16. Related party transactions

The Company paid a fee of $137,655 with respect to the private placement disclosed in note 9(c) to a company which is related to a significant shareholder.

17. Subsequent event

On December 19, 2001, the Company entered into a revised credit agreement with the bank. This agreement is for a continuation of the existing operating line at $10,000,000, with interest being charged at prime plus 2%. This facility is subject to certain covenants including the maintenance of specified debt-to-tangible net worth ratios calculated on a quarterly basis and meeting certain financial milestones.

notes

notes

AVCORP INDUSTRIES INC.

Board of Directors

Gordon Flatt (2)
Managing Director
Coastal Aerospace Group
Warwick, Bermuda

J. Ian Flatt (1*) (2)
Chairman
The Coastal Group
Winnipeg, Manitoba

Paul Kalil
Chief Operating Officer,
Aerostructures Division
Avcorp Industries Inc.
Managing Director
Coastal Aerospace Group
Vancouver, British Columbia

David Levi (1) (2)
Chairman of the Board
Avcorp Industries Inc.
President and CEO
GrowthWorks Capital Ltd.
Vancouver, British Columbia

John H. Nicholson
President and CEO
Avcorp Industries Inc.
West Vancouver, British Columbia

Michael C. Scholz (1) (2*)
President
Great Canadian Gaming Corporation
West Vancouver, British Columbia

(1) Member of the Audit and Corporate Governance Committee
(2) Member of the Human Resources and Compensation Committee
* Committee Chair

directory

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Vancouver, British Columbia

Legal Counsel

Fraser Milner Casgrain
Barristers & Solicitors
Vancouver, British Columbia

Goodman, Phillips & Vineberg
Barristers & Solicitors
Montreal, Quebec

Registrar and Transfer Agent

CIBC Mellon Trust Company
Vancouver, British Columbia

Auditors

PricewaterhouseCoopers LLP
Chartered Accountants
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